Defending Liberty
Pursuing Justice

TAXATION
A Section of the American Bar Association

Section of Taxation

Suite 400
1050 Connecticut Avenue, NW
Washington, DC 20036
202-662-8670
FAX: 202-662-8682
E-mail: tax@americanbar.org

July 23, 2018

David Kautter
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments Concerning the Treatment of Losses and Certain Other Issues with Respect to the Section 199A Deduction

Dear Acting Commissioner Kautter:

Enclosed please find the third installment of a larger project by the American Bar Association Section of Taxation (the "Section") to provide comments on changes made by the 2017 tax legislation in anticipation of forthcoming guidance from the Service on section 199A ("Comments"). These Comments address the treatment of losses and certain other technical issues in need of guidance with respect to the section 199A deduction. They are submitted on behalf of the Section and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association.

The Section will be pleased to discuss the Comments with you or your staff.

Sincerely,

Karen L. Hawkins
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Tax Legislative Counsel, Department of the Treasury
Krishna P. Vallabhaneni, Deputy Tax Legislative Counsel, Department of the Treasury
Audrey W. Ellis, Attorney-Advisor, Department of the Treasury
William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Scott K. Dinwiddie, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments Concerning the Treatment of Losses and Certain Other Issues Regarding the Section 199A Deduction

These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the "Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Comments are part of a larger project undertaken by the Section to provide comments on the changes made by last year's tax reform legislation (the "Act").[1] Because of the need for guidance, the Internal Revenue Service's expedited regulation process, and the fact that these Comments deal with important issues in interpreting new section 199A, these Comments are being submitted as part of the Section's general comments relating to section 199A and in response to requests by the Department of the Treasury and the Internal Revenue Service for comments on needed guidance under the Act.

Principal responsibility for preparing these Comments was exercised by Ryan Tucker. Significant contributions were also made by Jennifer Alexander, John Franco, Thomas Phillips, and Jay Nathanson. The Comments have been reviewed by Beverly Katz, Vice Chair of the Partnerships and LLCs Committee, Robert Honigman, Chair of the Real Estate Committee, Adam M. Cohen, Council Director for the Partnerships and LLCs Committee and Real Estate Committees, Ronald A. Levitt, Council Director for the S Corporations and Closely Held Business Committees, and Jeanne Sullivan of the Section's Committee on Government Submissions.

Although members of the Section who participated in preparing these comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member of the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Ryan Tucker
(206) 716-6249
rytucker@deloitte.com

Date: July 23, 2018

[1] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (sometimes referred to as the "Tax Cuts and Jobs Act" or "TCJA").

Background and Executive Summary

The Act made substantial changes in the tax rules applicable to the business activities of taxpayers, effective for the current tax year. We commend the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "Service") for their commitment to provide expedited guidance and we ask that Treasury and the Service consider the following suggestions in the upcoming guidance relating to section 199A.[2]

Section 199A provides for a deduction in the calculation of a taxpayer's taxable income for tax years beginning after December 31, 2017. There are several components to computing a taxpayer's section 199A deduction for any taxable year and many issues arise in connection with computing the correct amount of the deduction. Among these are the "qualified business income" ("QBI") of the taxpayer under section 199A(c), the "combined qualified business income amount" ("CQBI") of the taxpayer under section 199A(b)(1), "W-2 wages" under section 199A(b)(2)(B)(i) & (ii) and (b)(4)(A), and unadjusted basis of "qualified property" under section 199A(b)(2)(B)(ii) and (b)(6). We respectfully request that Treasury and the Service issue guidance under section 199A to address the following important issues:

1. Treatment of qualified businesses losses that are included or allowed in determining taxable income for the taxable year. We recommend that such guidance provide the following:

    a. Losses carried over under the Loss Carryover Rule[3] are attributed to the qualified trade or business from which the losses originated, rather than attributed to a notional qualified trade or business;

    b. An Overall Qualified Business Loss does not affect a section 199A deduction otherwise available with respect to qualified publicly traded partnership ("PTP") income and qualified real estate investment trust ("REIT") dividends earned in the same taxable year as an Overall Qualified Business Loss; and

    c. That (i) the sum of the deductible amounts for purposes of section 199A(b)(1)(A) cannot be less than zero and (ii) any negative sum of the deductible amounts for purposes of section 199A(b)(1)(A) do not carry over to a succeeding taxable year.

2. Treatment of qualified items of income, gain, deduction, and loss that are suspended under a different provision of the Code. We recommend that such guidance confirm that a loss suspended under a different provision retains both its characterization as a qualified item and its attribution to a particular trade or business.

[2] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated.

[3] Capitalized terms are defined below.

3. Treatment of losses from publicly traded partnerships. We recommend that such guidance provide that (i) Qualified PTP Losses are not included in a taxpayer's CQBI amount and (ii) any Qualified PTP Loss is carried over to the succeeding taxable year using mechanics similar to the Loss Carryover Rule.

4. Treatment of section 1231 gains and losses. We recommend that such guidance provide that (i) section 199A(c)(3)(A) does not include section 1231 gains and section 1231 losses in QBI for a taxable year where such gains exceed such losses, as such gains and losses are treated as long-term capital gains and long-term capital losses and are excluded by section 199A(c)(3)(B)(i), and (ii) section 199A(c)(3)(A) does include section 1231 gains and section 1231 losses in QBI for a taxable year where such losses exceed such gains, as such gains and losses are treated as ordinary income and losses and are not excluded by section 199A(c)(3)(B)(i). We also request guidance on the application of the section 1231(c) recapture rules to situations where a taxpayer has multiple trades or businesses, one or more of which generated the net section 1231 capital gain, and one or more of which generated the non-recaptured net section 1231 loss.

5. Confirmation that the section 199A deduction does not reduce net earnings from self-employment under section 1402. We recommend that such guidance clarify that the section 199A deduction is not a deduction which is applicable in determining net earnings from self-employment.

COMMENTS

I. Treatment of Qualified Business Losses under Section 199A

A. Treatment of Qualified Businesses Losses That Are Included or Allowed in Determining Taxable Income for the Taxable Year

1. Summary

This section will examine the mechanics of section 199A when a taxpayer has losses from qualified trades or businesses ("Qualified Business Loss(es)"), including how section 199A applies when a taxpayer has an overall loss from all of its qualified trades or businesses (an "Overall Qualified Business Loss").

The loss carryover rule in section 199A(c)(2) (the "Loss Carryover Rule") provides that if net qualified business income and losses from *all* of a taxpayer's qualified trades or businesses in a taxable year is less than zero, "such amount is treated as a loss from *a* qualified trade or business in the succeeding taxable year" (emphasis added).[4] Below, we provide recommendations with respect to the application of the Loss Carryover Rule in both the current and succeeding taxable years.

If a taxpayer does not have an Overall Qualified Business Loss, the Loss Carryover Rule does not apply. Even if a taxpayer does not have an Overall Qualified Business Loss, the taxpayer may still have Qualified Business Losses from individual qualified trades or businesses. Therefore, we also provide recommendations with respect to how Qualified Business Losses should impact the section 199A calculations when the Loss Carryover Rule does not apply.

2. Recommendations

We recommend that Treasury and the Service issue the following guidance under Section 199A with respect to losses from qualified trades or businesses:

(a) Provide that losses carried over under the Loss Carryover Rule are attributed to the qualified trade or business from which the losses originated, rather than attributed to a notional qualified trade or business;

---

[4] As a threshold matter, for purposes of section 199A, qualified business income and loss is limited to items "included or allowed in determining taxable income for the taxable year" under section 199A(c)(3)(A)(ii). This appears to mean that when other limitations result in a disallowance of a Qualified Business Loss at the individual taxpayer level, such losses are not taken into account at all for purposes of section 199A, including for purposes of applying the Loss Carryover Rule, until they are allowed as a deduction to the taxpayer in a subsequent taxable year. Therefore, in order to have an Overall Qualified Business Loss for a given taxable year in the first place, the loss must not be suspended for such year under another provision of the Code, such as section 461(l), which we discuss in more detail below.

(b) Confirm that an Overall Qualified Business Loss does not affect a section 199A deduction otherwise available with respect to qualified PTP income and qualified REIT dividends earned in the same taxable year as an Overall Qualified Business Loss, and

(c) Provide that (i) the sum of the deductible amounts for purposes of section 199A(b)(1)(A) cannot be less than zero and (ii) any negative deductible amounts for purposes of section 199A(b)(1)(A) do not carry over to a succeeding taxable year.

3. **Explanation**

(a) Provide that losses carried over under the Loss Carryover Rule are attributed to the qualified trade or business from which the losses originated, rather than attributed to a notional qualified trade or business

As discussed above, the statute provides that an Overall Qualified Business Loss is "treated as a loss from *a* qualified trade or business in the succeeding taxable year."[5] The reference to "a" is unclear. It could be interpreted as attributable to a notional qualified trade or business that is unconnected to the taxpayer's qualified trade or business, or as attributable to a qualified trade or business of the taxpayer (*i.e.*, the qualified trade or business that gave rise to the loss). An example in the Conference Report suggests that the carryover loss is a notional item related to a notional qualified trade or business.[6] In that case, in a succeeding taxable year when the taxpayer has sufficient QBI, 20% of the Overall Qualified Business Loss carried over

---

[5] I.R.C. § 199A(c)(2) (emphasis added).

[6] *See* H.R. Conf. Rep. No. 115-466, at 37 (Dec. 18, 2017) (the "Conference Report"). Example 2, which uses the original 23% deduction rate in the Senate amendment, provides the following illustration:

> H and W file a joint return on which they report taxable income of $200,000 (determined without regard to this provision). H has a sole proprietorship qualified trade or business that is not a specified service business ("qualified business A"). W is a partner in a qualified trade or business that is not a specified service business ("qualified business B"). H and W have a carryover qualified business loss of $50,000.
>
> H's qualified business income from qualified business A is $150,000, such that 23 percent of the qualified business income with respect to the business is $34,500. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business A. H's deductible amount for qualified business A is $34,500.
>
> W's allocable share of qualified business loss is $40,000, such that 23 percent of the qualified business loss with respect to the business is $9,200. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business B. W's deductible amount for qualified business B is a reduction to the deduction of $9,200.
>
> H and W's combined qualified business income amount of $13,800 is comprised of the deductible amount for qualified business A of $34,500, the reduction to the deduction for qualified business B of $9,200, and the reduction to the deduction of $11,500 attributable to the carryover qualified business loss [*i.e.*, $50,000 carryover loss x 23%]. H and W's deduction is limited to 23 percent of their taxable income for the year ($200,000), or $46,000. Accordingly, H and W's deduction for the taxable year is $13,800.

reduces the taxpayer's section 199A deduction with respect to its QBI.[7] This concept is illustrated by the following example.

Example #1

In Year 1, an individual taxpayer has a taxable loss of ($50 million) from Business A (a qualified trade or business) and taxable income of $100 million from Business B (a nonqualified trade or business).[8] In Year 2, the taxpayer has taxable income of $80 million from Business A and no taxable income from Business B. Assume the taxpayer's limitation under section 199A(b)(2)(B) (the "Wage and Basis Limitation") in Year 2 with respect to Business A is $11 million.

Because the taxpayer has an Overall Qualified Business Loss in Year 1 of ($50 million), all from Business A, the Loss Carryover Rule applies to treat the $50 million loss as "a loss from a qualified trade or business in the succeeding taxable year."

If a notional qualified trade or business concept is adopted, in Year 2, the taxpayer would be treated as having two qualified trades or businesses: Business A with QBI of $80 million and a notional qualified trade or business with a Qualified Business Loss of $50 million. The deductible amounts for the notional qualified trade or business and Business A would be determined separately. The deductible amount for the notional qualified trade or business is 20% of the ($50 million) loss, or ($10 million).[9] The deductible amount with respect to the $80 million of QBI from Business A is the lesser of $16 million (20% of $80 million) or $11 million (the Wage and Basis Limitation).[10] Therefore, the sum of the deductible amounts is $1 million (($10 million) plus $11 million) despite overall QBI of $30 million (($50 million) plus $80 million).

If the carryover loss of ($50 million) from Business A was not attributable to a notional qualified trade or business and, instead, was attributable to Business A in the following year, the taxpayer would have a deductible amount of $6 million (the lesser of $6 million (20% of $30 million) or $11 million (the Wage and Basis Limitation)).

Although the legislative history may be read to treat the carryover loss as a notional qualified trade or business ("Notional QTB Approach"), the legislative history is not clear and

---

[7] *Id.*

[8] For example, a specified service trade or business under section 199A(d)(2).

[9] The notional qualified trade or business does not have any W-2 wages or qualified property, so the Wage and Basis Limitation is not applicable.

[10] While some commentary has suggested that the Qualified Business Loss be allowed to offset the QBI before the application of the Wage and Basis Limitation, the statute seems clear that the deductible amount must be determined separately for each qualified trade or business. In its comment letter regarding the section 199A deduction, the New York State Bar Association presented a "pre-limitation netting" approach, whereby losses from qualified trades or businesses would be offset against gains from qualified trades or businesses before applying the Wage and Basis Limitation. *See* N.Y. State Bar Ass'n Tax Section, Report No. 1392 on Section 199A Deduction (Mar. 23, 2018), *reprinted in* 2018 TNT 58-16.

we believe that the better policy answer is to attribute each component of the carryover loss to the trade or business to which it originally related (the "Retained QTB Approach"). The outcome of answers in the example in the Conference Report would be the same under either the Notional QTB Approach or the Retained QTB Approach. In addition, the statutory language does not preclude either interpretation. Accordingly, we recommend that guidance adopt the Retained QTB Approach rather than the Notional QTB Approach.

(b) Confirm that an Overall Qualified Business Loss does not affect a section 199A deduction otherwise available with respect to qualified PTP income and qualified REIT dividends earned in the same taxable year as the Overall Qualified Business Loss

Whether or not a taxpayer can fully benefit from a 20% section 199A deduction with respect to qualified PTP income and qualified REIT dividends could depend on whether an Overall Qualified Business Loss that is required to be carried over is taken into account in the CQBI of the taxpayer in the current taxable year. By its terms, the Loss Carryover Rule applies *only* to qualified items of income, gain, deduction, and loss when a taxpayer has an Overall Qualified Business Loss.[11] Because qualified PTP income and qualified REIT dividends are specifically *excluded* from the definition of QBI,[12] qualified PTP income and qualified REIT dividends appear to not be subject to the Loss Carryover Rule. Additionally, section 199A(b)(1)(B) specifically provides that 20% of qualified PTP income and qualified REIT dividends is *included* in the CQBI of a taxpayer. As a result, such amounts can apparently still generate a current year section 199A deduction even for a taxpayer that has an Overall Qualified Business Loss, provided the taxpayer has sufficient nonqualified taxable income in excess of net capital gains. In other words, qualified PTP income and qualified REIT dividends may receive the benefit of a 20% section 199A deduction *even if* a taxpayer has an Overall Qualified Business Loss.

Although we believe the better interpretation of section 199A(b)(1)(B) and (c)(1) is that the Loss Carryover Rule prevents an Overall Qualified Business Loss from being taken into account in determining CQBI,[13] one could argue that an Overall Qualified Business Loss is still taken into account to reduce the deductible amounts determined under section 199A(b)(2). However, such an interpretation can lead to anomalous results, as illustrated by the following two examples.

<u>Example #2</u>

[11] I.R.C. § 199A(c)(2).

[12] I.R.C. § 199A(c)(1).

[13] *See* Am. Inst. of CPAs, Request for Immediate Guidance Regarding IRC Section 199A – Deduction for Qualified Business Income of Pass-Through Entities (Pub. L. No. 115-97, Sec. 11011) (Feb. 21, 2018), *reprinted in* 2018 TNT 36-31. The American Institute of CPAs ("AICPA") has requested an example interpreting the Loss Carryover Rule under what appears to be this intended application.

An individual taxpayer has a taxable loss of $50 million from Business A (a qualified trade or business), taxable income of $100 million from Business B (a nonqualified trade or business), and $120 million of qualified REIT dividends.[14]

Because the taxpayer has an Overall Qualified Business Loss, the Loss Carryover Rule provides that the taxpayer's Overall Qualified Business Loss of ($50 million), all from Business A, is taken into account in the succeeding taxable year.

Under what we believe is the better reading of the statute, the taxpayer's Overall Qualified Business Loss of ($50 million) is carried over to the succeeding taxable year and is not taken into account in the taxpayer's CQBI in the current year.

Thus, the taxpayer's CQBI is $24 million because 20% of the taxpayer's $120 million of qualified REIT dividends is included in CQBI under section 199A(b)(1)(B).

The taxpayer's section 199A deduction is then computed as follows:

> x = lesser of ([$24 million of CQBI] or [20% x $170 million of taxable income in excess of net capital gain]) = $24 million

Therefore, despite the Overall Qualified Business Loss, the taxpayer has a section 199A deduction of $24 million, generated by the $120 million of qualified REIT dividends.

If the statute is read so that the Overall Qualified Business Loss would result in a negative deductible amount under section 199A(b)(2) *even though* it is treated as a Qualified Business Loss in the succeeding year by operation of the Loss Carryover Rule, it creates the potential for double (or more) counting of Overall Qualified Business Losses, as illustrated in the following example.

Example #3

Assume the same facts as Example #2, except that the taxpayer also has $120 million of qualified REIT dividends in the following taxable year. For purposes of this example, assume that an alternative reading of the statute is applied, and a deductible amount is determined for Business A even when the Loss Carryover Rule applies.

With regard to the initial year, the deductible amount for Business A is 20% of ($50 million), or ($10 million).[15] Thus, the taxpayer's CQBI is $14 million, comprised of the

[14] For purposes of these examples, we are ignoring the impact of the standard deduction on the taxable income limitation under section 199A(a)(2).

[15] Note that the Wage and Basis Limitation cannot be less than zero, so even if Business A has substantial wages and basis in qualified property for purposes of section 199A, 20% of the Qualified Business Loss generated by Business A will always be the smaller number. In addition, it seems relatively clear that a deductible amount with respect to a trade or business can be negative. Qualified business income is defined as a "the net amount of qualified items of income, gain, *deduction*, and *loss*." Also, an example in the Conference Report describes a taxpayer's deductible

($10 million) deductible amount from Business A,[16] and 20% of the $120 million of qualified REIT dividends, or $24 million.

If recommendation (a) above is not adopted, the taxpayer would also be deemed to have ($50 million) of loss from a notional qualified trade or business in the succeeding year, so the section 199A deduction with respect to the $100 million of qualified REIT dividends received in the following year is reduced by the same ($50 million) of Qualified Business Loss that reduced the deduction in the first year. Because this alternative reading results in the double counting of a single loss for purposes of section 199A, it does not appear to be an appropriate interpretation of the statute.

An Overall Qualified Business Loss is clearly carried over into the succeeding taxable year, but whether the Overall Qualified Business Loss is also taken into account in the current year is a little unclear. Therefore, we recommend that guidance be issued to confirm that a taxpayer's current year section 199A deduction with respect to qualified PTP income and qualified REIT dividends is not affected by an Overall Qualified Business Loss.

(c) Provide that (i) the sum of the deductible amounts for purposes of section 199A(b)(1)(A) cannot be less than zero and (ii) any negative sum of the deductible amounts for purposes of section 199A(b)(1)(A) do not carry over to a succeeding taxable year

As discussed above, the Loss Carryover Rule specifically carries over an Overall Qualified Business Loss. There is not a similar carryover mechanism where a taxpayer has overall QBI, but the sum of all deductible amounts is negative. As illustrated in the following example, this situation could arise as a result of the Wage and Basis Limitation applying to income-generating qualified trades or businesses.

Example #4

Assume the same facts as Example #2 above, except that Business B is a qualified trade or business with a Wage and Basis Limitation of zero (*i.e.*, Business B has neither W-2 wages nor qualified property).

Because there is overall QBI of $50 million ($100 million from Business B and ($50 million) from Business A), the Loss Carryover Rule does not apply and none of the ($50 million) of loss from Business A carries over. Nevertheless, the taxpayer has a negative sum of the deductible amounts. That is, Business B has a deductible amount of zero,[17] and Business A has a deductible amount of ($10 million).

---

amount for a loss business as a "reduction to the deduction." *See* H.R. Conf. Rep. No. 115-466, at 37 (Dec. 18, 2017). Example 2 is included in its entirety in note 7, above.

[16] For purposes of this example, we assume that the negative sum of the deductible amounts under section 199(b)(1)(A) reduces CQBI. This issue is discussed in detail below.

[17] Calculated as the lesser of $20 million (20% x $100 million) or zero (the Wage and Basis Limitation).

Because the Loss Carryover Rule does not apply, the negative deductible amount may be taken into account in the current year. As a result, the taxpayer has a CQBI of $14 million, which is the sum of the deductible amounts of ($10 million), plus $24 million (20% of the $120 million of qualified REIT dividends).

The taxpayer's section 199A deduction is then determined as follows:

> *x* = *lesser of* ([$14 million of CQBI] *or* [20% x $170 million of taxable income in excess of net capital gain]) = $14 million

Unlike the result in Example #2, where there was an Overall Qualified Business Loss, the Qualified Business Loss from Business A in this example impacts the deduction otherwise generated by the qualified REIT dividends.

This result is interesting because the Qualified Business Loss from Business A does not reduce the taxpayer's section 199A deduction with respect to QBI from Business B, a result that was clearly illustrated in the Conference Report.[18] Instead, because there is no deductible amount from Business B to reduce, the negative deductible amount from Business A reduces the taxpayer's section 199A deduction with respect to qualified REIT dividends of the taxpayer (which are specifically *excluded* from QBI and taken into account separately as CQBI).

It is unclear whether this is the intended result of section 199A, and it may not be obvious that a taxpayer with overall QBI might not get a full 20% deduction with respect to its qualified REIT dividends. As shown in Example #2, if Business B was a specified service trade or business instead of a qualified trade or business, the taxpayer would not have any limitation with respect to the section 199A deduction on its qualified REIT dividends because the Loss Carryover Rule would apply. This could effectively penalize such a taxpayer for having a qualified trade or business rather than a specified service trade or business.

We do not believe taxpayers should be worse off as a result of having more qualified trade or business income. Thus, we recommend that guidance provide that the sum of deductible amounts cannot be less than zero. This recommendation is not inconsistent with Example 2 in the Conference Report, which contemplates a negative deductible amount reducing a positive deductible amount.[19] In other words, the legislative history provides that a negative deductible amount can reduce the positive deductible amount from other qualified trades or business, but it does not indicate the intended consequences when the sum of the deductible amounts is negative.

Where there is no positive deductible amount to reduce (or the negative deductible amount is greater than the positive deductible amount), the deductible amount should be zero. Future guidance will hopefully clarify this mechanism.

---

[18] *See* H.R. Conf. Rep. No. 115-466, at 37 (Dec. 18, 2017). When calculating the taxpayer's CQBI, a negative deductible amount with respect to a qualified trade or business with a net taxable loss is used to reduce the positive deductible amount with respect to a qualified trade or business with net taxable income. However, the taxpayer's CQBI is still positive.

[19] *See* H.R. Conf. Rep. No. 115-466, at 37 (Dec. 18, 2017). Example 2 is included in its entirety in footnote 4, above.

If a negative deductible amount is not taken into account in computing CQBI, the next question that arises is whether a negative deductible amount should be carried forward similar to an Overall Qualified Business Loss under the Loss Carryover Rule. Without a rule similar to the Loss Carryover Rule, a taxpayer's negative sum of the deductible amounts could never be taken into account, as shown in the following example.

<u>Example #5</u>

Assume the same facts as Example #4, except that there are no qualified REIT dividends in the current year. Instead, the $120 million of qualified REIT dividends is received in the following taxable year, and the taxpayer has no income or loss from Business A or Business B in that following taxable year.

The negative sum of the deductible amounts is the same in the current year because Business A has a negative deductible amount of ($10 million) and Business B has a deductible amount of zero. However, unlike Example #4, CQBI is not $14 million, but, rather, ($10 million) because the qualified REIT dividends are not received until the following taxable year.

Without a carryover mechanism similar to the Loss Carryover Rule, the ($10 million) negative deductible amount in the first year would not affect the taxpayer's ability to deduct a full $24 million (*i.e.*, 20% of $120 million) with respect to the qualified REIT dividends in the succeeding year.[20]

We believe the better interpretation of the statute is that the Loss Carryover Rule does not apply where there is overall QBI, even where a taxpayer has a negative sum of the deductible amounts for purposes of section 199A(b)(1)(A). In addition, this interpretation seems consistent with congressional intent. As described above, a taxpayer can have a negative sum of the deductible amounts if the taxpayer has overall QBI but insufficient Wage and Basis Limitation for at least one qualified trade or business. Although not entirely clear, it seems that the policy intent was to carryover Qualified Business Losses (as is evidenced by the Loss Carryover Rule), but not to carryover wages and basis amounts. Stated differently, the Wage and Basis Limitation is an annual test. It is very clear that any unused Wage and Basis Limitation does not carryforward to future years. By the same token, the lack of sufficient Wage and Basis Limitation should not carryover to future years. Carrying over a negative sum of deductible amounts would have the effect of carrying over a taxpayer's insufficient Wage and Basis Limitation, so we believe that not carrying over a negative sum of deductible amounts yields the better policy result.

As discussed in this section, there may be unexpected results when a taxpayer has overall QBI, but the Wage and Basis Limitation causes the sum of deductible amounts under section

[20] The result would be the same if the $120 million of income in the succeeding year was from Business A instead of qualified REIT dividends. In other words, the lack of a carryover mechanism with respect to negative deductible amounts appears to prevent the negative deductible amount in the current year from affecting the section 199A deduction with respect to QBI, qualified REIT dividends, or qualified PTP income in the succeeding year.

199A(b)(1)(A) to be negative. Although nothing in the language of the statute prevents an overall negative deductible amount from flowing through the rest of the calculation, it produces inappropriate results. Thus, we request that guidance provide that (i) the sum of the deductible amounts for purposes of section 199A(b)(1)(A) cannot be less than zero, and (ii) any negative sum of the deductible amounts for purposes of section 199A(b)(1)(A) do not carry over to a succeeding taxable year.

B. Treatment of Qualified Items of Income, Gain, Deduction, and Loss that are Suspended under a Different Provision of the Code

1. Summary

The preceding section focused on the impact of losses from a qualified trade or business once it enters the section 199A calculation. This section examines the potentially unexpected consequences when Qualified Business Losses are suspended and do not affect the section 199A calculations in the taxable year in which they are incurred.

As mentioned above, items of income, gain, deduction, and loss are only includible as "qualified items of income, gain, deduction, and loss" to the extent such items are "included or allowed in determining taxable income for the year."[21] Therefore, if an item of income, gain, deduction, or loss is suspended under a loss limitation regime, it will not factor into the determination of QBI until it is included or allowed in a subsequent year. However, the manner in which suspended losses impact the section 199A calculations when included or allowed in a subsequent year is unclear.

2. Recommendation

We recommend that Treasury and the Service issue guidance under section 199A to confirm that a loss suspended under a different provision retains both its characterization as a qualified item and its attribution to a particular trade or business.

3. Explanation

While there are many instances in which a loss may be limited, such as the basis limitations for partnerships and S corporations under sections 704(d) and 1366(d), or the passive activity and at-risk limitations under sections 469 and 465, this section focuses on the new limitation on excess business losses of non-corporate taxpayers under section 461(l).

The section 461(l) limitation disallows a non-corporate taxpayer's excess business loss, which is defined as the excess (if any) of the *aggregate deductions* attributable to trades or businesses, over the aggregate gross income or gain attributable to such trades or businesses, plus

[21] I.R.C. § 199A(c)(3)(A)(ii).

$250,000 (or $500,000 in the case of a joint return).[22] A disallowed excess business loss is treated as a net operating loss carryover in the following taxable year.[23]

Based on the language of the statute, it appears that only the *excess deduction items* are disallowed, rather than the *entire* net business loss. Additionally, the section 461(l) limitation applies to all trades or business, regardless of whether such trades or businesses are "qualified" for purposes of the section 199A deduction. These are important distinctions when analyzing this limitation's effect on the section 199A calculations.

Example #6 below illustrates how a taxpayer can still take advantage of a deduction under section 199A despite having an excess business loss that is limited under section 461(l).

Example #7 and Example #8 illustrate the uncertainties with respect to how a taxpayer tracks the characterization of disallowed losses for purposes of calculating the section 199A deduction in a subsequent taxable year.

Example #6

An individual taxpayer has $100 million of non-business income, $50 million of net income from Business A (a qualified trade or business), and ($100 million) of net loss from Business B (a nonqualified trade or business). The taxpayer's Wage and Basis Limitation with respect to Business A is $20 million.

It is clear that ($50 million) of deductions will be disallowed as excess business losses under section 461(l).[24] Assuming that Business A has ($30 million) of deductions, Business B has ($120 million) of deductions, and the limitation on excess business losses is applied among businesses pro-rata based on deductions,[25] the taxpayer's adjusted gross income for the year could be calculated as follows:

Non-Business Income	$100 million
Business A Income (Loss)	$60 million [26]
Business B Income (Loss)	($60 million) [27]

[22] I.R.C. § 461(l)(3)(A).

[23] I.R.C. § 461(l)(2).

[24] For purposes of these examples, we are ignoring the $250,000 and $500,000 thresholds provided under section 461(l)(3)(A)(ii)(II).

[25] There are other methods that could be adopted, such as allocating the excess business losses among trades or businesses based on the relative net loss of the businesses. However, in the absence of guidance, allocating the limitation based on relative deductions appears to be reasonable.

[26] Calculated as $50 million, plus $10 million of deductions disallowed under section 461(l) ($50 million x ($30 million / $150 million)). As illustrated in the following example, the $10 million excess business loss attributable to Business A would likely need to be tracked separately when included in taxable income in a subsequent year.

[27] Calculated as ($100 million), plus $40 million of deductions disallowed under section 461(l) ($50 million x ($120 million / $150 million)).

Adjusted Gross Income $100 million

The taxpayer has an overall loss from all trades or businesses, but the only business with a net loss is Business B, which is not a qualified trade or business for purposes of section 199A. Although the taxpayer has net income from Business A, the section 461(l) limitation is partially comprised of deductions from Business A. Therefore, the taxpayer has $60 million of QBI from Business A, and can take a section 199A deduction equal to the lesser of $12 million (20% of $60 million) or $20 million (the Wage and Basis Limitation).[28]

This example demonstrates how the presence of a nonqualified trade or business loss can actually increase a taxpayer's QBI and section 199A deduction due to the mechanics of section 461(l).

<u>Example #7</u>

In Year 1, an individual taxpayer has $100 million of non-business income and ($50 million) of net loss from Business A (a qualified trade or business). In Year 2, the taxpayer has $100 million of non-business income and $130 million of net income from Business A. The taxpayer's Wage and Basis Limitation with respect to Business A is $20 million for both years.

In Year 1, the taxpayer's excess business loss of $50 million is disallowed under section 461(l) and is treated as a net operating loss carryover in Year 2. Because the $50 million net operating loss carryover does not exceed 80% of the taxable income for Year 2,[29] the entire $50 million of loss is allowed in Year 2.

There appear to be multiple ways to characterize the suspended excess business loss in Year 2, when it is included or allowed for taxable income purposes and thus taken into account for section 199A purposes:

(1) If the $50 million loss from Year 1 is not considered a loss from *any* qualified trade or business for purposes of section 199A, then the taxpayer's QBI with respect to Business A is $130 million, and the deductible amount with respect to Business A is $20 million.[30] This results in a section 199A deduction of $20 million.

(2) If the $50 million loss from Year 1 is considered a loss attributable to Business A for purposes of section 199A, then the taxpayer's QBI with respect to Business A

[28] Note that the section 199A deduction is not affected by the taxable income limitation under section 199A(a)(2) because the taxpayer has sufficient non-business income.

[29] I.R.C. § 172(a)(2).

[30] Calculated as the lesser of $26 million ($130 million x 20%) or $20 million (Wage and Basis Limitation).

is $80 million, and the deductible amount for Business A is $16 million.[31] This results in a section 199A deduction of $16 million.

(3) If the $50 million loss from Year 1 is considered a loss attributable to a *notional* qualified trade or business for purposes of section 199A,[32] then the taxpayer's QBI with respect to Business A is $130 million, the deductible amount for Business A is $20 million,[33] and the deductible amount with respect to the carryover Qualified Business Loss is ($10 million).[34] Therefore, the CQBI and section 199A deduction are $10 million.

We believe that guidance should adopt the approach whereby a loss suspended under 461(l) retains both its characterization as a qualified item and its attribution to a particular trade or business (*i.e.*, the second approach above).[35]

Example #8

Assume the same facts as Example #7, except that the taxpayer also has $120 million of net income from Business B (a nonqualified trade or business) in Year 1. In Year 1, there is no section 461(l) limitation and the entire Business A loss is included or allowed in taxable income. However, if recommendation (a) above is not adopted, the $50 million of Qualified Business Loss would be carried over and treated as a loss from a notional trade or business in Year 2 under the Loss Carryover Rule.

In Year 2, the taxpayer's QBI with respect to Business A is $130 million, the deductible amount for Business A is $20 million,[36] and the deductible amount with respect to the carryover Qualified Business Loss would be ($10 million).[37] Therefore, the taxpayer's CQBI and section 199A deduction would be $10 million.

This example shows how it could be advantageous from a section 199A perspective to have net qualified losses limited under section 461(l) or another loss suspension regime *instead* of applying the unfavorable Notional QTB Approach discussed above in recommendation (a).[38] We note that if recommendation (a) is adopted and the Retained QTB Approach is applied

[31] Calculated as the lesser of $16 million ($80 million x 20%) or $20 million (Wage and Basis Limitation).

[32] This would be similar to the interpretation of the Loss Carryover Rule discussed in recommendation (a) above.

[33] Calculated as the lesser of $26 million ($130 million x 20%) or $20 million (Wage and Basis Limitation).

[34] Calculated as the lesser of ($10 million) (($50 million) x 20%) or $0 (Wage and Basis Limitation).

[35] This is consistent with the recommendation made by the AICPA. *See* Am. Inst. of CPAs, Request for Immediate Guidance Regarding IRC Section 199A – Deduction for Qualified Business Income of Pass-Through Entities (Pub. L. No. 115-97, Sec. 11011) (Feb. 21, 2018), *reprinted in* 2018 TNT 36-31.

[36] Calculated as the lesser of $26 million ($130 million x 20%) or $20 million (Wage and Basis Limitation).

[37] Calculated as the lesser of ($10 million) (($50 million) x 20%) or $0 (Wage and Basis Limitation).

[38] This depends on what guidance is issued with respect to the issue highlighted in Example #7, as the outcome in Example #8 is the same as the third approach in Example #7.

instead,[39] there would be no difference between a loss limited under section 461(l) and a loss carried over under the Loss Carryover Rule.

C. Treatment of Losses from Publicly Traded Partnerships

1. Summary

We discussed above whether a negative sum of the deductible amounts ought to reduce a taxpayer's CQBI and whether a negative sum of the deductible amounts ought to be carried over to a succeeding taxable year. This section addresses similar issues with respect to qualified PTP income.

Qualified PTP income is the net amount of a taxpayer's allocable share of qualified items of income, gain, deduction, and loss from a PTP,[40] plus any ordinary gain recognized on the disposition of the PTP interest under section 751(a).[41]

Although losses from a PTP are generally suspended by operation of the passive activity rules,[42] there are several situations in which a taxpayer can have a net loss from PTPs that is allowable in determining the taxable income:

- An insider could be active in the PTP under the material participation rules of Temporary Regulation section 1.469-5T. Therefore, losses from such PTP could be deducted against other taxable income.

- A taxpayer could sell its interest in a PTP for a capital gain. Under section 199A(e)(4)(B), that capital gain would not be qualified PTP income, but it would allow the taxpayer to deduct other losses from that PTP.

- A taxpayer could dispose of his or her entire interest in a PTP, which would cause all current year losses and prior year suspended losses to be allowable for purposes of section 469.[43]

In any of these situations, the amount of qualified PTP income could be negative. Given that neither the statute nor the Conference Report contemplates a situation where a taxpayer's overall qualified PTP income is negative, additional guidance is needed to determine the

[39] As explained above, we believe that this is the better result from a policy perspective.

[40] I.R.C. § 199A(e)(4)(A).

[41] I.R.C. § 199A(e)(4)(B).

[42] The majority of taxpayers who invest in PTPs do not materially participate under Temporary Regulation section 1.469-5T. Additionally, section 469(k)(1) provides that the passive activity rules apply separately will respect to each PTP, so passive losses from one PTP cannot offset passive income from other PTPs.

[43] *See* I.R.C. § 469(g), (k)(3).

appropriate treatment of such amounts. Specifically, guidance should confirm (i) whether negative overall qualified PTP income ("Qualified PTP Loss") is included when determining a taxpayer's CQBI amount, and (ii) whether Qualified PTP Loss should carry over to the succeeding taxable year.

2. **Recommendation**

We recommend that Treasury and the Service issue guidance under section 199A to provide that (i) Qualified PTP Losses are not included in a taxpayer's CQBI amount and (ii) any Qualified PTP Loss is carried over to the succeeding taxable year using mechanics similar to the Loss Carryover Rule.

If a correction to the statute would be necessary to achieve the result described above, then we recommend that Treasury and the Service issue guidance under section 199A to clarify the appropriate treatment of Qualified PTP Losses under the current statutory language.

3. **Explanation**

Similar to the negative sum of the deductible amounts discussed above, the statutory language of section 199A appears to include Qualified PTP Losses in CQBI. However, as described above, a negative sum of the deductible amounts arises when a taxpayer has *positive* overall QBI, but the Wage and Basis Limitation eliminates the stand-alone deductible amounts with respect to individual qualified trades or businesses with positive QBI. The Wage and Basis Limitation does not apply to qualified PTP income, so Qualified PTP Losses result from actual losses, rather than the application of the Wage and Basis Limitation. Thus, Qualified PTP Losses are not comparable to negative sums of the deductible amounts, but are instead analogous to Overall Qualified Business Losses.

Because Qualified PTP Losses are analogous to Overall Qualified Business Losses, we believe it is appropriate to apply a rule similar to the Loss Carryover Rule to Qualified PTP Losses. As discussed with respect to recommendation (b) above, it appears that Congress intended to prevent Overall Qualified Business Losses from reducing the potential section 199A deduction with respect to qualified PTP income and qualified REIT dividends. The Loss Carryover Rule provides that Overall Qualified Business Losses affect the potential section 199A deduction with respect to QBI in succeeding taxable years. If an analogous rule were to apply to Qualified PTP Losses, any Qualified PTP Loss would be carried over to a succeeding taxable year instead of being included in the current year CQBI. Thus, a Qualified PTP Loss would reduce the potential section 199A deduction with respect to qualified PTP income in future taxable years, instead of reducing any potential section 199A deduction with respect to qualified REIT dividends and QBI in the current taxable year. Similar to the Loss Carryover Rule, a taxpayer would need positive cumulative qualified PTP income before computing a deduction with respect to qualified PTP income in a given taxable year.

While we believe that carrying over Qualified PTP Losses is the better policy answer, it is unclear whether Treasury and the Service could issue guidance to achieve that result given the current language of the statute. CQBI includes "20 percent of the aggregate amount of the qualified REIT dividends and qualified [PTP] income of the taxpayer for the taxable year."[44] Qualified PTP income is generally defined as the sum of (i) the net amount of a taxpayer's allocable share of each qualified item of income, gain, deduction, and *loss* from a PTP and (ii) any gain recognized by the taxpayer upon disposition of its interest under section 751(a).[45] Although the statute references "loss" in the definition of Qualified PTP income, we believe it may nevertheless be possible to interpret the statute to indicate that losses are taken into account, but that Qualified PTP income must still nevertheless be *income*, and, therefore a positive number. If so, a carryover rule could be adopted with respect to Qualified PTP Losses.

We recommend that, if possible, Treasury and the Service issue guidance providing that Qualified PTP Losses are carried over to offset future qualified PTP income instead of reducing CQBI. If Treasury and the Service believe they do not have the authority to issue that guidance, then a correction to section 199A may be needed to achieve the most appropriate policy result and Treasury and the Service should issue guidance to clarify the treatment of Qualified PTP Losses in the absence of a correction.

II. Treatment of Section 1231 Gains or Losses

1. Summary

Under section 199A(c)(1), QBI is defined to be for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. However, there are a number of items that are excluded from QBI. Under section 199A(c)(3)(B)(i), any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss is excluded from the computation of QBI. It is not entirely clear how section 1231 gains or losses are treated for purposes of computing QBI, particularly when multiple qualified trades or businesses are involved.

2. Recommendation

We recommend that Treasury and the Service issue guidance under section 199A to provide that (i) section 199A(c)(3)(A) does not include section 1231 gains and section 1231 losses in QBI for a taxable year where such gains exceed such losses, as such gains and losses are treated as long-term capital gains and long-term capital losses and are excluded by section 199A(c)(3)(B)(i), and (ii) section 199A(c)(3)(A) does include section 1231 gains and section 1231 losses in QBI for a taxable year where such losses exceed such gains and are treated as ordinary income and losses and are not excluded by section 199A(c)(3)(B)(i). We also request

[44] I.R.C. § 199A(b)(1)(B).

[45] I.R.C. § 199A(e)(4).

guidance on the application of the section 1231(c) recapture rules to situations where a taxpayer has multiple trades or businesses, one or more of which generated the net section 1231 capital gain, and one or more of which generated the non-recaptured net section 1231 loss.

3. **Explanation**

The term "QBI" for purposes of section 199A means any item of income, deduction, gain, or loss of a qualified trade or business of the taxpayer that is effectively connected with a U.S. trade or business and included in determining taxable income for the taxable year.[46] There are specified items that are excluded from QBI, such as any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.[47]

Generally, section 1231 gain means any recognized gain from a sale or exchange of property used in a trade or business, and section 1231 loss means any recognized loss from a sale or exchange of property used in a trade or business.[48] The definition of property used in a trade or business requires that the property be held more than one year, among other requirements.[49] Property used in a trade or business is not a capital asset.[50] If section 1231 gains exceed section 1231 losses in any taxable year, such gains and losses are generally treated as long-term capital gains or long-term capital losses for such taxable year.[51] If section 1231 gains do not exceed section 1231 losses in any taxable year, such gains and losses are not be treated as gains or losses from sales or exchanges of capital assets[52] and are treated as ordinary gains and losses.[53] In addition, the net section 1231 gain for a taxable year is treated as ordinary income to the extent such gain does not exceed the non-recaptured net section 1231 losses.[54]

Under section 199A(c)(3)(B)(i), QBI should exclude section 1231 gains and section 1231 losses for a taxable year where such gains exceed such losses because they are treated as long-term capital gains and long-term capital losses. However, where section 1231 gains and section 1231 losses are treated as ordinary items of income or loss, such items should be included in QBI because the section 199A(c)(3)(B)(i) exception would not apply. As discussed in more detail below, it is not entirely clear if QBI should include net section 1231 gain that results in ordinary income to the extent of the non-recaptured net section 1231 losses.

---

[46] I.R.C. § 199A(c)(1), (c)(3).

[47] *See* I.R.C. § 199A(c)(3)(B), (c)(4).

[48] I.R.C. § 1231(a)(3).

[49] I.R.C. § 1231(b)(1).

[50] I.R.C. § 1221(a)(2).

[51] I.R.C. § 1231(a)(1).

[52] I.R.C. § 1231(a)(2).

[53] Reg. § 1.1231-1(b).

[54] I.R.C. § 1231(c)(1).

As originally enacted, the beginning of section 199A(c)(3)(B) read "[t]he following investment items shall not be taken into account." Subsequent to the enactment of the Act, the beginning of section 199A(c)(3)(B) was amended by the Consolidated Appropriations Act to remove the word "investment,"[55] effective as if included in the Act. Based on the original version of section 199A(c)(3)(B), section 1231 gains and section 1231 losses could be construed to be included in QBI because they arise from property used in a trade or business and not an investment. However, the removal of the word "investment" from section 199A(c)(3)(B) supports the interpretation that section 1231 gains and section 1231 losses treated as long-term capital gains and long-term capital losses should be excluded from QBI. The Joint Committee Technical Explanation of the Consolidated Appropriations Act further supports this interpretation by stating QBI does not include any item of net capital gain or net capital loss.[56]

It is somewhat troubling that section 1231 gains or section 1231 losses can be included or excluded from QBI based their character even though the property was used in a trade or business that produces QBI. However, if section 1231 gains or losses treated as long-term capital gains or losses were included in QBI, the capital gains tax rate on such income effectively and inappropriately would be further reduced by the QBI deduction.

As a result, we generally believe that the character of the income, as ordinary income or capital gain, should govern its treatment under section 199A. However, it is not entirely clear how section 1231 net capital gains should be treated when a taxpayer has multiple trades or businesses and the section 1231 net capital gain is treated as ordinary income under the section 1231(c) recapture rule.

Example #9

Assume an individual taxpayer conducts two trades or businesses. Business A is a qualified trade or business with sufficient Wage and Basis Limitation in all years to take the full 20% section 199A deduction, and Business B is a specified service trade or business.

In year 1, Business A has $90 million of section 1231 gains and Business B has $100 million of section 1231 losses. Since the taxpayer's section 1231 losses exceed section 1231 gains, all section 1231 gains and losses are treated as ordinary. Business A is treated as having $90 million of ordinary income and should result in an $18 million section 199A deduction. Business B is a specified

[55] Pub. L. No. 115-141, § 101(b)(2)(B)(i)(l), 132 Stat. 348, 1156 (2018).

[56] Staff of the Joint Comm. on Taxation, JCX-6-18, Technical Explanation of the Revenue Provisions of the House Amendment to the Senate Amendment to H.R. 1625 (Rules Committee Print 115-66), at 7 (Mar. 21, 2018) (the "Joint Committee Technical Explanation of the Consolidated Appropriations Act").

service trade or business and generally does not qualify for the section 199A deduction.[57]

In year 2, Business A has $100 million of section 1231 gains and Business B has $90 million of section 1231 losses. Under the section 1231 general rule, all of the gains and losses will be treated as capital and would otherwise be excluded from QBI; however, the section 1231(c) recapture rule would apply and treat $10 million of net capital gain as ordinary income.[58]

If the ordinary income is considered attributable to Business A, the trade or business that generated the net capital gain, then Business A would be entitled to an additional $2 million section 199A deduction. If, instead, the ordinary income is considered attributable to Business B, the trade or business from which the net unrecaptured loss related, then no additional section 199A deduction would be permitted.

The application of the section 1231(c) recapture rule becomes more complicated the greater number of businesses involved. We recommend that guidance address the application of the section 1231(c) recapture rule to section 199A and provide rules to apportion, trace, or track the recapture to separate businesses.

III. Whether the Deduction for QBI Reduces Net Earnings from Self-Employment for Purposes of Computing the Tax on Self-Employment Income

1. Summary and Explanation

Section 199A(f)(3) provides that the deduction under section 199A(a) shall only be allowed for purposes of *this chapter*. Section 199A is in Chapter 1 (Normal Taxes and Surtaxes) of Subtitle A (Income Taxes) of the Code. Taxes on self-employment income are contained in Chapter 2 (Tax on Self-Employment Income), also under Subtitle A of the Code. Accordingly, under a strict reading of the statute, it is clear that the section 199A deduction is not allowed for purposes of the tax on self-employment income because that tax is imposed under a different chapter than the chapter including the section 199A deduction. As far as we have observed, the commentators have reached the conclusion, without much discussion, that the section 199A deduction is not allowed for purposes of the tax on self-employment income.[59]

[57] *See* I.R.C. § 199A(d)(2), (3).

[58] This assumes that the only non-recaptured net section 1231 loss under section 1231(c)(2) is the $10 million net section 1231 loss from year 1.

[59] *See, e.g.*, Bahar A. Schippel, *To Be or Not to Be, a C Corporation*, J. OF PASSTHROUGH ENTITIES, Mar.-Apr. 2018, at 69, 71; Matthew A. Melone, *The Deduction for Pass-Through Income and Its Effect on the Choice of Entity*, PRACTICAL TAX STRATEGIES, Feb. 2018, at 4, 9.

Section 199A(f)(3) is entitled "Deduction Limited to Income Taxes." The Conference Report states that "[t]he deduction under the provision is allowed only for Federal income tax purposes."[60] Since the tax on self-employment income is under Subtitle A of the Code, for income taxes, this statement, as well as the title of section 199A(f)(3), could be construed to imply that the deduction was intended to apply for self-employment tax purposes as well as for purposes of the section 1 and section 3 taxes under Chapter 1 of Subtitle A of the Code.

Such implication might find some support in Regulation section 1.1402(a)-2(a), which provides, in pertinent part, that "[i]n general, the gross income *and deductions* of an individual attributable to a trade or business … for purposes of ascertaining his net earnings from self-employment, are to be determined by reference to the provisions of law and regulations applicable with respect to the taxes imposed by sections 1 and 3" (emphasis added). The Regulation goes on to use accrual accounting and the installment method as examples of two methods that if used for income tax purposes must be used for self-employment tax purposes.[61]

2. **Recommendation**

We recommend that Treasury and the Service clarify that the section 199A deduction is not a deduction which is applicable in determining net earnings from self-employment.[62]

[60] *See* H.R. Conf. Rep. No. 115-466, at 35 (Dec. 18, 2017).

[61] Less to the point, but somewhat relevant, Regulation section 1.1401-1 provides, in pertinent part, with respect to the tax on self-employment income, that "[t]his tax shall be levied, assessed, and collected as part of the income tax imposed by subtitle A of the Code and, except as otherwise expressly provided, will be included with the tax imposed by section 1 or 3 in computing any deficiency, overpayment, or tax."

[62] Consideration should be given to amending Regulation section 1.1402(a)-2(a) to specifically exclude from the computation of net earnings from self-employment the section 199A deduction.